STATE OF ALABAMA

DEPARTMENT OF INSURANCE

REPORT OF EXAMINATION

of

HEALTHSPRING OF ALABAMA, INC.

BIRMINGHAM, ALABAMA

as of

DECEMBER 31, 2004

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EXAMINATION AFFIDAVIT

STATE OF ALABAMA
COUNTY OF JEFFERSON

Rhonda B. Ball being first duly sworn, upon her oath deposes and says:

That she is an examiner appointed by the Commissioner of Insurance for the State of Alabama;

That an examination was made of the affairs and financial condition of HealthSpring of Alabama, Inc. for the period of January 1, 2002 through December 31, 2004;

That the following 57 pages constitute the report thereon to the Commissioner of Insurance of the State of Alabama;

And, that the statements, exhibits, and data therein contained are true and correct to the best of her knowledge and belief.

Rhonda B Ball

Rhonda B. Ball
Examiner-in-charge

Subscribed and sworn to before the undersigned authority this day of October 13, 2006.

Constance Woolweaver
(Signature of Notary Public)

Constance Woolweaver, Notary Public
Printed name

in and for the State of Alabama

My commission expires 11/8/2004

GOVERNOR
Bob Riley

STATE OF ALABAMA
DEPARTMENT OF INSURANCE
EXAMINATION DIVISION
201 Monroe Street, Suite 1700
Post Office Box 303351
Montgomery, Alabama 36130-3351
Telephone: (334) 269-3550
Facsimile: (334) 240-3194

COMMISSIONER
Walter A. Bell

Deputy Commissioner
D. David Parsons

Chief Examiner
Richard L. Ford

State Fire Marshal
Ed Paulk

General Counsel
Reyn R. Norman

Birmingham, Alabama
October 13, 2006

Honorable Walter A. Bell
Commissioner of Insurance
State of Alabama
Department of Insurance
Post Office Box 303350
Montgomery, Alabama 36130-3350

Dear Commissioner Bell:

Pursuant to your instructions and in compliance with the statutory requirements of the State of Alabama and the resolutions adopted by the National Association of Insurance Commissioners, an examination has been made of the affairs and condition of

HealthSpring of Alabama, Inc.
Birmingham, Alabama

as of December 31, 2004, at its home office located at Two Perimeter Park South, Suite 300 West, Birmingham, Alabama, 35243. The report of examination is submitted herewith.

Where the term, Company, appears herein without qualification, it is synonymous with HealthSpring of Alabama, Inc.

SCOPE OF EXAMINATION

The examination reported herein covers the period from January 1, 2002 through December 31, 2004 and has been conducted by examiners representing the Alabama Department of Insurance. Events subsequent to December 31, 2004 have been reviewed and are reported herein as deemed appropriate.

The Company has been examined in accordance with the statutory requirements of the State of Alabama for a Health Maintenance Organization, and in accordance with applicable laws of the State of Alabama; Alabama Insurance Departmental regulations, bulletins and directives; and in accordance with the applicable guidelines and procedures of the NAIC; and in accordance with generally accepted examination standards.

The examination included a general review of the Company's operations, administrative practices and compliance with statutes and regulations. Income and disbursement items were tested for selected periods. Assets were verified and valued and all known liabilities were established or estimated as of December 31, 2004, as shown in the financial statements contained herein. However, the discussion of assets and liabilities contained in this report has been confined to those items which resulted in a change to the financial statements, or which indicated a violation of the *Alabama Insurance Code* and the Insurance Department's rules and regulations or other insurance laws or rules, or which where deemed to require comments and/or recommendations.

A signed certificate of representation was obtained during the course of the examination. In this certificate, management attested to having valid title to all assets and to the nonexistence of unrecorded liabilities as of December 31, 2004. A signed letter of representation was also obtained at the conclusion of the examination, whereby management represented that, through the date of this examination report, complete disclosure was made to the examiners regarding asset and liability valuation, financial position of the Company, and contingent liabilities.

The market conduct phase of the examination consisted of a review of the Company's territory, plan of operation, policy forms and underwriting practices, rating, policyholder services, advertising and marketing, compliance with agents' licensing requirements, claims handling practices, and the Company's compliance with privacy regulations (ALA. ADMIN. CODE 482-1-122 (2001)).

ORGANIZATION AND HISTORY

The Company began operations on April 1, 1985, as a health maintenance organization, licensed by the state of Alabama. The original name of the Company was "Sunmark Health Plans."

On May 28, 1986, the Company was purchased by Baptist Health Systems, Inc. (BHS), formerly Baptist Medical Centers, and the name was changed to "Samaritan Health Plans." BHS is a non-profit corporation, which later formed a for-profit holding company, BHS Affinity, Inc. (BHSA) and transferred ownership of the Company to BHSA. On February 28, 1988, the name of the Company was changed to "Partners Health Plan of Alabama, Inc." On September 22, 1992, the Company's name was changed to "Health Partners of Alabama, Inc."

On January 1, 1995, the Company merged with Gulf Health Plans HMO, Inc. (GHP) with the Company as the surviving entity. Infirmary Health System, Inc. (IHS), parent of GHP, had its shares in GHP converted into 620 shares of the Company, making it a minority shareholder. As a result of the merger, the Company was owned 89% by BHS and 11% by IHS.

On March 1, 1995, the Company purchased a third party administrator, Gulf Health Plans, Inc. and purchased HPA Administrative Services, Inc. from BHS. Upon the effective date of the purchase, HPA Administrative Services, Inc. was merged into Gulf Health Plans, Inc. with HPA Administrative Services, Inc. as the surviving corporation. It was a wholly owned subsidiary of the Company.

On August 16, 1996, BHSA and IHS formed a holding company, Health Partners Southeast, Inc. (HPSE). BHSA and IHS each contributed their ownership interest in the Company to HPSE. Upon consummation of the transaction, HPSE became 100% owner of the Company, and HPSE was owned 89% by BHS and 11% by IHS.

On September 23, 1996, HPSE purchased PCA Health Plan of Alabama, Inc., PCA Health Plan of Georgia, Inc. and Health Strategies, Inc. The name of PCA Health Plan of Alabama, Inc. was changed to "Merit Health Plan of Alabama, Inc." (Merit). PCA Health Plan of Georgia's name was changed to "HPC Health Plans of Georgia, Inc." Both of these HMOs were affiliates of the Company. Health Strategies, Inc. was an affiliate of the Company.

On April 28, 1998, an Order to Show Cause concerning the violation of Alabama Department of Insurance Regulation No. 101, Hazardous Financial Condition was issued due to the Company's losses exceeding 50% of its net worth as stated in the 1997 Annual Statement. As a result, monthly financial statements were sent to the Department. The Order was lifted May 7, 1999, due to the sworn statement by BHS's Chairman, Mr. Green, that BHS would continue to financially support the Company as long as it was owned by the Hospital. The Commissioner required the Company to maintain a $3 million stand-by letter of credit in favor of the Alabama Insurance Department as an added precaution against the violation of the aforementioned regulation.

On April 14, 1999, at a Form A hearing, BHS purchased the remaining 11% of HPSE from IHS. The purchase price was an agreement and a guarantee that the full and prompt payment of $23 million in notes issued by HPSE pursuant to the terms of a fiscal agency agreement dated August 1, 1996 between HPSE and AmSouth Bank of Alabama would be paid in full. As of April 14, 1999, HPSE was a wholly owned subsidiary of BHS.

On September 30, 1999, the Company merged with Merit. The Company remained as the surviving corporation after the merger. The outstanding shares of Merit were cancelled as of September 30, 1999, and HPSE owned 5,000 shares of the Company.

On March 10, 2000, an Order to Show Cause for violating Alabama Department of Insurance Regulation 101, Hazardous Financial Condition, was issued because the Company's losses exceeded 50% of its net worth as stated in its 1999 Annual Statement. A hearing to suspend the certificate of authority was set for April 11, 2000. On March 31, 2000, a Continuation of the Notice of Hearing was made and granted until such time as a Form A hearing on the acquisition of the Company could be scheduled.

On March 24, 2000, BHS received a letter of intent from Venture Health Partnership Group, LLC (VHPG), a Delaware limited liability company, to purchase all the issued and outstanding shares of capital stock and assets of Health Partners Southeast, Inc. (HPSE).

On June 8, 2000, a Form A hearing was held at the Alabama Department of Insurance, in which the sale of the Company was approved by the acting Alabama Insurance Commissioner to be effective on June 1, 2000. At said meeting, a document illustrating the breakdown of payments made and to-be-made by BHS was distributed. BHS made two capital contributions in the amounts of $5,643,000 and $18,420,771 prior to closing the sale. Part of the contributions was used to write down the affiliate receivables for BHS, Baptist Medical Centers, Montclair Hospital and Princeton Hospital.

On November 13, 2000, the Company's name was changed to The Oath- A Health Plan for Alabama, Inc.

On March 23, 2001, an Order to Show Cause for violating Alabama Department of Insurance Regulation 101, Hazardous Financial Condition, was issued because the Company's losses exceeded 50% of its net worth as stated in its 2000 Annual Statement. A hearing to suspend the certificate of authority was set for April 18, 2001. On April 18, 2001, a Continuation of the Notice of Hearing was made and no new hearing date was set at that time.

On June 5, 2001, a Notice of Continuation of Hearing was made and a hearing date was rescheduled for July 11, 2001. This hearing was cancelled and another Order to Show Cause was issued on September 4, 2001.

On September 5, 2001, an Order was issued to immediately cease paying any monies out of the Company for any and all consulting fees due to the Company continuing to be in a hazardous financial condition, which was placing the enrollees at risk. Additionally, all administrative expenses, prior to being paid, were to be reviewed by Ms. Denise Azar, Acting Chief, Receivership Division of the Department.

A hearing was set for September 18, 2001, but then was rescheduled for September 20, 2001. At the September 20, 2001 hearing, there was sworn testimony by Company officials that within five days approximately $1.5 million would be wire transferred into the Company and then disbursed for settlement in the dispute with Baptist Health Systems, Inc. Additional testimony indicated other steps being taken to provide further infusion of capital into the Company, so as to resolve its financial impairment. The Commissioner agreed, at the close of the hearing, to leave the record open in this proceeding until October 11, 2001, for the purpose of receiving additional documentation to evidence the Company's testimony.

On September 24, 2001, it was ORDERED that the record would remain open until October 11, 2001, to permit Company representatives to file additional documentary evidence in support of their position and testimony noted above at the September 20, 2001 hearing. It was also ORDERED that the Company immediately cure its financial impairment and provide evidence to the

Department that this had occurred, no later than September 25, 2001. This evidence was to include a September 30, 2001 *pro forma* balance sheet indicating the Company's expected financial condition. The Commissioner also REQUESTED the Company to voluntarily stop the marketing of its products to new groups. It was also ORDERED that until further supporting information was received and reviewed by the Department, the management agreement between the Company and Scheur Management Group (SMG) was hereby DISAPPROVED. No further payments were to be made by the Company to SMG under this agreement until further ordered. The Commissioner ORDERED that the Company immediately provide documentation regarding each consultant employed with the Company under the management agreement to include each consultant's position or job title, time sheets for the consultants' work schedule at the Company, and copies of any documentation evidencing the work product of these consultants.

On October 17, 2001, an ORDER was issued stating that the Company had until November 15, 2001 to file its September 30, 2001 financial statement and submit additional documentary evidence including actuarial studies to support the financial assumptions indicating whether additional funds were needed to remain solvent into the foreseeable future, in which case said additional funds should be infused into the Company no later than November 20, 2001; that beginning November 2001 through and including April 2002, the Company will submit certified monthly financial statements using the format of the National Association of Insurance Commissioners quarterly statement blank (jurat page and first seven pages), to be filed within thirty days of the end of the next month; and, that the Company will continue to be under the oversight of the Department pursuant to the terms of the Agreement to Continue Hearing dated July 11, 2001.

In October 2001, a surplus note was issued by Venture Health Partnership Group, Inc., in order to meet the minimum statutory requirements by the Alabama Department of Insurance.

On June 6, 2002, an order to Show Cause was issued because of the Company's financial statement as of April 30, 2002, which showed the capital and surplus was impaired by approximately $614,162. On June 28, 2002, the Order to Show Cause was lifted.

On November 19, 2002, NewQuest, LLC acquired the Company and changed the Company's name to HealthSpring of Alabama, Inc. NewQuest, LLC is a Texas limited liability corporation that owns and manages HealthSpring, Inc., a

Community Health Plan in Nashville, Tennessee and GulfQuest in Houston, Texas, an IPA management company. NewQuest, LLC was founded and is partly owned by Herb Fritch, Chairman and CEO of HealthSpring.

On January 1, 2003, NewQuest Management of Alabama, LLC, was formed to act as a management company for the Company.

The Company's authorized capital stock consisted of 120,000 shares of common stock. At December 31, 2004, there were 5,620 shares issued and outstanding at $20 stated value per share resulting in $112,400 issued and outstanding.

GROWTH OF THE COMPANY

The following schedule presents financial data, which reflects the growth of the Company for the years indicated:

Year	Premium & Related Revenue	Admitted Assets	Liabilities	Capital & Surplus
2001*	211,865,970	28,427,057	29,039,086	-612,029
2002	88,511,502	11,488,276	9,246,208	2,242,068
2003	93,930,820	19,733,712	15,761,286	3,972,425
2004*	134,978,713	25,539,750	19,261,867	6,277,883

*Data for the years 2001 and 2004 were per examinations. Data for 2002 and 2003 was obtained from the related Annual Statement.

SURPLUS

Sources of Capital and Surplus

The Company's authorized capital stock consisted of 120,000 shares of common stock, of which 5,620 were outstanding. At December 31, 2004, common capital stock consisted of $112,400 derived from 5,620 shares at a stated value of $20 per share. Gross paid in and contributed surplus was $7,540,236. Capital and surplus amounts were increased by an unassigned funds (surplus) amount of $25,246, resulting in total capital and surplus in the amount of $7,677,882, per the Company's 2004 Annual Statement. Examination adjustments reduced the Company's capital and surplus to $6,277,883.

The Company experienced a net loss of $(1,572,857) for 2002 and net income for 2003 and 2004 of $842,324 and $3,670,789, respectively. Examination adjustments decreased the Company's 2004 net income to $2,270,789.

STATUTORY DEPOSITS

In accordance with the requirements of Section 27-21A-12, Code of Alabama 1975, as amended, the Company maintained the following deposits with the State of Alabama, at December 31, 2004:

	Par Value	Statement Value	Market Value
AmSouth Bank, CD	$ 200,000	$ 200,000	$ 200,000
AmSouth Bank, CD	800,000	800,000	800,000
Total	$1,000,000	$1,000,000	$1,000,000

CORPORATE RECORDS

The Alabama Department of Insurance, effective November 19, 2002, permitted NewQuest, LLC to purchase the Company from Venture Health Partnership Group, LLC. The Company's Certificate of Incorporation, By-laws and related amendments were inspected and were found to provide for the operation of the Company. The following two amendments were made during the examination period:

- The Articles of Incorporation were amended on November 19, 2002 to change the name of the Company from The Oath - A Health Plan of Alabama, Inc. to HealthSpring of Alabama, Inc.
- The Company's By-laws were amended and restated on October 19, 2002.

Records of the meetings and actions of the Stockholder, Board of Directors and various committees, since December 31, 2001, were reviewed. The records appeared to be complete and accurately reflect the actions of the respective corporate bodies with the exception of the following:

- The amendment to the Articles of Incorporation and the amendment to the By-laws were not reflected as being approved within the Company's minutes.
- Article IV Section 1 of the Company's By-laws requires the Board of Directors to select "a minimum of 3 members" to committees created by the Board. After a review of the Company's Board of Directors' meeting minutes, there was no indication of the election or selection of committee members for the Company's committees during the examination period. This was also noted in the prior examination.
- A review of the Board of Directors meeting minutes indicated that the Company held its annual Board of Directors meeting in March 2002, 2003 and 2004. The 2005 annual meeting was held in February. The Company provided the minutes of the Shareholders for 2002. However, there was no evidence of any other Shareholders meetings during the examination period. This was a violation of the Company's By-laws, which states that the Company will hold an annual meeting of its shareholders for the election of directors and the transaction of general business in January of each year. The By-laws also state that the annual meeting of the Board of Directors will be held immediately following the annual shareholder's meeting for the purpose of electing officers and the transaction of other business.
- Review of the minutes of the Board of Directors indicated that no investments were approved or ratified by the Board of Directors for the period under examination, which was in conflict with ALA. CODE § 27-41-5(1975), which requires that:

  > "An insurer shall not make any investment or loan, other than loans on policies or annuity contracts, unless the same be authorized, approved or ratified by the board of directors of the insurer or by such committee..."

MANAGEMENT AND CONTROL

Stockholder

At December 31, 2004, NewQuest, LLC owned 100% of the Company's common capital stock.

Board of Directors

According to the Company's Charter and By-laws, the board of directors shall manage its business and dealings. The amendments to the Articles of Incorporation specified that the number of directors should be no less than three natural persons.

Directors that were elected on November 19, 2002 and were serving at December 31, 2004 are as follows:

Director/Address	Principal occupation
Herbert Allen Fritch Nashville, Tennessee	Chairman/Chief Executive Officer/Managed Care Executive HealthSpring affiliates
William Bradley Green* Birmingham, Alabama	President HealthSpring of Alabama, Inc. and NewQuest Management of Alabama, LLC.
Steven Richard Adams Brentwood, Tennessee	Chief Operation Officer North American Holding Company
John Friend Jordan, III Brentwood, Tennessee	Chief Operating Officer North American Holding Company
Jeffrey Lynn Rothenberger Nashville, Tennessee	Managed Care Executive HealthSpring affiliates

* Replaced Michael D. Nadler in November 2003 and was replaced by Rene Phillip Moret in January 2006.

Committees

The following are the committees the Company had in place at December 31, 2004:

- Corporate Quality Improvement
- Clinical Quality Improvement

- Utilization Management
- Physician Advisory Committee
- Pharmacy and Therapeutic Committee
- Credentialing Committee

The Company could not provide evidence that its board of directors selected members for its committees in accordance with Article IV Section 1 of its By-laws. This was also noted in the prior examination report.

The following committees were established in accordance with Department of Public Health standards:

Corporate Quality Improvement

The minutes of the last meeting prior to year-end 2004, dated October 20, 2004, identified the following persons as committee members:

Hugh M. Hood, MD
William Bradley Green, President
Cheryl DeBold, RN
Jim Laughlin
Cherie Ard
Sandra Lutz, VP of Information Systems
Pam Leverett
Cindy Williams
Harvey Smith
DeWayne Green

Clinical Quality Improvement

The minutes of the last meeting prior to year-end 2004, dated October 19, 2004, identified the following persons as committee members:

Hugh M. Hood, MD
Theodis Buggs, MD
Paul Scalici, MD
John Farley, MD
Greer Geiger, MD
C. Michael Buchanan, MD
William Edge, MD

Utilization Management

The minutes of the last meeting prior to year-end 2004, dated October 19, 2004, identified the following persons as committee members:

C. Michael Buchanan, MD
Hugh M. Hood, MD
William Edge, MD
William Bradley Green
Cheryl DeBold, RN
Anne Laplante
Pam Leverett
Paul Scalici, MD
John Farley, MD
Greer Geiger, MD

Physician Advisory Committee

The minutes of the last meeting prior to year-end 2004, dated December 14, 2004, identified the following persons as committee members:

Hugh Hood, MD
Juan Johnson, MD
C. Michael Buchanan, MD
Rian Montgomery, MD
Paul Scalici, MD
Anthony Brooklere, Registered Pharmacist
John Morgan, MD
Jacqueline Stewart, MD
Theodis Buggs, MD
John Gerwin, MD
Marshall Boone, MD
Kenneth Elmer, MD
Elizabeth Stahl, MD
Lora Pound, MD

Pharmacy and Therapeutic

The minutes of the last meeting prior to year-end 2004, dated June 1, 2004, identified the following persons as committee members:

Hugh M. Hood, MD
John Morgan, MD
John Gerwin, MD
Lora Pound, MD
Marshall Boone, MD
Rian Montgomery, MD
Cathy Munn, Director of Quality Improvement
Kenneth Elmer, MD
Anthony Brooklere, Registered Pharmacist
William Bradley Green, President
Wendy Bottomley
Cheryl DeBold, RN

<u>Credentialing Committee</u>

The minutes of the last meeting prior to year-end 2004, dated December 20, 2004, identified the following persons as committee members:

Hugh M. Hood, MD
John Dumas, MD
E. Scott Elledge, MD
John C. Foster, MD
Rex A. Sherer, MD
Jacqueline Stewart, MD
John Upchurch, MD
Mahender A. Reddy, MD

<u>Officers</u>

According to the Company's March 1, 2004 Board of Directors minutes, the election of officers was passed; however, a listing of these officers was not included within the minutes. The Company did not have a Vice-Chairman at December 31, 2004, which was required by Article V Section 1 of its By-laws. Company management represented that the following officers were serving at December 31, 2004:

Herbert A. Fritch	Chairman/Chief Executive Officer
William Bradley Green	President
Jeffrey L. Rothenberger	Secretary
Steven R. Adams	Treasurer

Teresa R.J. Jordan	Assistant Secretary
Cynthia Williams	Chief Financial Officer
Hugh Marvin Hood	Senior Medical Director

Conflict of Interest

One 2003 signed conflict of interest statement was provided and five 2004 signed conflict of interest statements were provided for the period under examination; however, conflict of interest statements were not provided for all officers, directors or key employees for each year under examination. This was also noted in the prior examination report and was contradictory to the Company's answer to general interrogatory number fourteen in its 2004 Annual Statement, which asks "Has the reporting entity an established procedure for disclosure to its board of directors or trustees of any material interest or affiliation on the part of any of its officers, directors, trustees or responsible employees which is in or likely to conflict with the official duties of such person."

HOLDING COMPANY AND AFFILIATE MATTERS

Holding Company Registration

The Company was not subject to the *Alabama Insurance Holding Company Regulatory Act*, as defined in Section 27-29-1, Code of Alabama 1975, as amended, except as expressly required by other statutes and regulations. Generally, HMOs are subject to regulation in regard to changes in control, but are not subject to the continuing holding company reporting requirements that apply to insurance companies.

On March 24, 2000, Baptist Health Systems, Inc. received a letter of intent from Venture Health Partnership Group, LLC (VHPG), a Delaware limited liability company, to purchase all the issued and outstanding shares of capital stock and assets of Health Partners Southeast, Inc. (HPSE). On June 8, 2000, a Form A hearing was held at the Alabama Department of Insurance, in which the sale was approved by the Acting Alabama Insurance Commissioner to be effective on June 1, 2000. On November 13, 2000, the Company's name was changed to The Oath - A Health Plan for Alabama, Inc.

On November 19, 2002, NewQuest, LLC acquired the Company and changed the Company's name to HealthSpring of Alabama, Inc. NewQuest is a Texas holding company that owns and manages HealthSpring, Inc., a Community Health Plan in Nashville, Tennessee and GulfQuest in Houston, Texas, an IPA management company. NewQuest was founded and is partly owned by Herb Fritch, Chairman and CEO of HealthSpring.

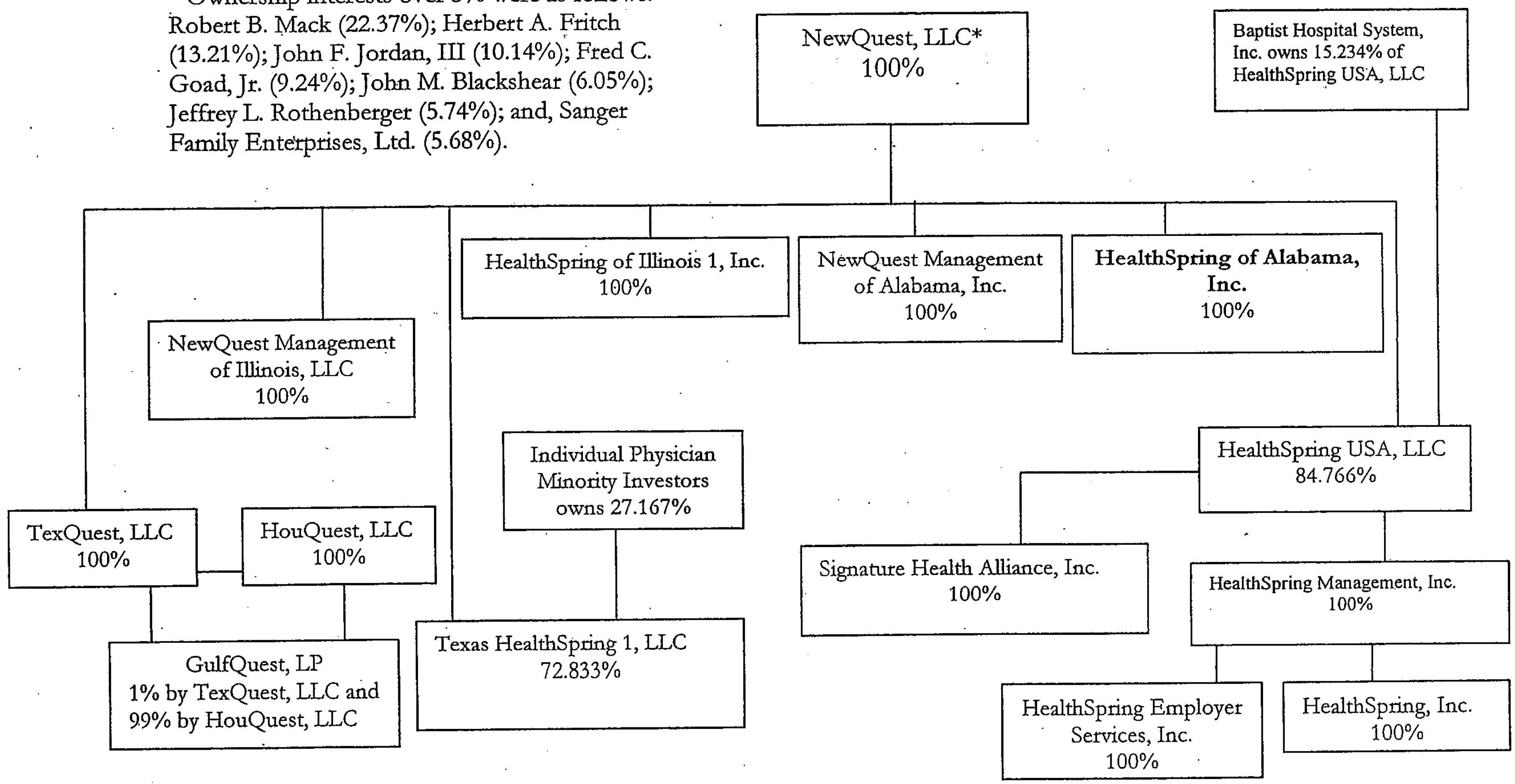
On January 1, 2003, NewQuest Management of Alabama, LLC, was formed to act as a management company for the Company.

Organizational Chart

The Company did not complete its 2004 Schedule Y- Part 1 in accordance with the NAIC Annual Statement Instructions. The Company's 2004 Schedule Y-Part 1 did not reflect the controlling persons of NewQuest, LLC. The persons with over 5% ownership were as follows: Robert B. Mack (22.37%); Herbert A. Fritch (13.21%); John F. Jordan, III (10.14%); Fred C. Goad, Jr. (9.24%); John M. Blackshear (6.05%); Jeffrey L. Rothenberger (5.74%); and, Sanger Family Enterprises, Ltd. (5.68%).

The following chart presents the identities of and interrelationships among all affiliated persons within the Insurance Holding Company System at December 31, 2004 and includes the ultimate controlling person:

* Ownership interests over 5% were as follows: Robert B. Mack (22.37%); Herbert A. Fritch (13.21%); John F. Jordan, III (10.14%); Fred C. Goad, Jr. (9.24%); John M. Blackshear (6.05%); Jeffrey L. Rothenberger (5.74%); and, Sanger Family Enterprises, Ltd. (5.68%).



Management and Service Agreements

At December 31, 2004, the Company was a party to the following agreement with its affiliate:

Management services agreement between NewQuest Management of Alabama, LLC and HealthSpring of Alabama, LLC

The agreement was effective January 1, 2003. Throughout the agreement, HealthSpring of Alabama was referred to as ("HealthSpring") and NewQuest was referred to as ("Manager").

- 2.1- Manager is the sole and exclusive agent for management and administration of certain business functions for HealthSpring.
- 2.2- Authority was delegated to Manager and HealthSpring without restriction.
- 3.1- Manager shall provide management and administrative services in accordance with HealthSpring's operational needs, laws, rules, and regulations.
- 3.2- Manager shall assist HealthSpring to establish and monitor procedures that promote the consistency, quality, and appropriateness of health care.
- 3.3- Manager shall maintain all regulatory permits for the operation of HealthSpring.
- 3.4.1- Manager is responsible for all aspects of its personnel.
- 3.6- Manager shall act under special powers of attorney for HealthSpring and have access to HealthSpring's bank account.
- 3.7.1- HealthSpring shall deliver an annual fiscal operational budget to Manager 60 days in advance.
- 3.7.2- Manager shall administer all accounting procedures and controls. Manager shall supervise the preparation and deliver to HealthSpring end of year and monthly statements.
- 3.7.3- HealthSpring has the right to examine and audit all accounts maintained by Manager.
- 3.8- Manager shall be responsible for all HealthSpring tax returns and reports.
- 3.9- Manager shall create, prepare, and file timely reports and records on HealthSpring's behalf.
- 3.11- Manager shall keep HealthSpring information confidential.
- 3.12- Manager shall maintain its own insurance.

- 3.14- Manager shall be responsible for the preparation of all premium tax and regulatory assessment filings at its own expense. At HealthSpring's request, Manager shall, at HealthSpring expense, file protests and applications regarding government of taxing authorities.
- 3.16- All personal property, lease payments either for real estate or equipment, shall be at Manager's expense, even if the lease is in HealthSpring's name.
- 4.2- HealthSpring shall arrange for medical care through its providers.
- 4.6- HealthSpring shall at its own expense maintain appropriate insurance.
- 5.1- HealthSpring agrees to pay Manager monthly management fees by the 10th of each month as evidenced in Exhibit A.
- 6.1- The agreement is binding for one year and shall be reviewed each year or within 60 days notice of cancellation.
- 6.2.2- If either party defaults, it has 30 days, or 10 days for nonpayment of fees, to cure the default.
- 6.3.1- Upon termination of the agreement, neither party shall have any further liabilities except those accrued. Promises and covenants expressly made to extend beyond the termination date shall remain in force.
- 8.1.1- This agreement supersedes all previous agreements.

Exhibit A

Expense Category	Commercial Expense.	Medicare Expense	Total Expense
Salaries & Benefits	$4,438,905	$2,730,17	$7,169,075
Broker Comm. - Medicare	-	$1,581,750	$1,851,750
Depreciation/Amortization/Leases	$126,119	$87,181	$$213,300
Audit/Legal/Consulting	$158,166	$109,334	$267,500
Advertising & Promotion	$347,671	$240,329	$588,000
Occupancy	$831,926	$575,074	1,407,000
Other Administrative Expenses	$3,373,985	$1,824,911	$5,198,896
Projected NewQuest Actual Expenses	$9,276,772	$7,148,749	$16,425,521
HealthSpring of Alabama Member Months	270,076	75,400	345,476

PMPM based on Actual NewQuest Management Expenses	$34.35	$94.81	$47.54

<u>Amendment to management services agreement by and between HealthSpring of Alabama, Inc. and NewQuest Management of Alabama, LLC</u>

The effective date of this amendment was January 1, 2004. Within the agreement, HealthSpring of Alabama, Inc. is referred to as HealthSpring and NewQuest Management of Alabama, LLC is referred to as Manager.

- Exhibit A was replaced by an amended Exhibit A.

Exhibit A: Management Fee Reimbursement Schedule

Management fees for HealthSpring members will be paid to Manager based upon a per member per month amount specific to each product defined below:

Medicare	$105 per member per month
Commercial and other	$37 per member per month

The total management fee charged for any month is not to exceed 14% of total HealthSpring Commercial revenue plus 15.825% of total HealthSpring Medicare revenue for that month.

The Manager's expenses that will be allocated to HealthSpring will approximate the schedule below based on product type and expense category. These figures are based on forecast 2004 results and will vary if actual results differ from projections.

Manager Administrative Expense Breakdown:

	Commercial Expenses	Medicare Expenses	Total Expenses
Salaries and benefits	$3,784,576	$ 4,588,970	$ 8,373,546
Broker commissions- Medicare	-	1,539,000	1,539,000
Depreciation/ Amortization/ Leases	512,533	621,468	1,134,000
Audit/ Legal/ Consulting	1,173,438	1,422,846	2,596,284
Advertising and Promotion	422,346	512,114	934,460
Occupancy	524,283	635,717	1,160,000
Other Admin Expenses	1,315,703	931,586	2,247,289

Margin	1,072,261	1,817,520	2,889,781
Projected NewQuest Actual Expense	$8,805,139	$12,069,221	$20,874,360
HealthSpring of Alabama, Inc. Member months	256,616	117,888	374,504
PMPM based on Actual NewQuest Management Expenses:	$34.31	$102.38	$55.74
Percent of revenue	14.00%	15.825%	15.00%

- Section 3.12- Manager's Insurance shall be deleted and replaced in its entirety with Section 3.12- Manager's Insurance as set for in this amendment, effective January 1, 2004. Section 3.12- Manager's Insurance- Throughout the Term, Manager shall, at HealthSpring's expense, obtain and maintain with commercial carriers, self-insurance or some combination of these, appropriate workers' compensation coverage for Manager's employed personnel provided pursuant to this Agreement, and casualty and comprehensive general liability insurance, including an employee dishonesty policy, covering Manager, Manager's personnel and all of Manager's equipment in such amounts, on such basis and upon such terms and conditions as Manager deems appropriate. Such amounts shall be, at a minimum, maintained at the following levels: $500,000: Workers compensation and employers liability; $1,000,000- $2,000,000: General Liability; and $725,000: Property and casualty.

Management services agreement between NewQuest Management of Alabama, LLC and HealthSpring USA, LLC

The Company was not a party to this agreement; however, it was named within the service agreement.

This agreement is between NewQuest Management of Alabama, LLC (Manager) and HealthSpring USA, LLC, a Tennessee limited liability company (HealthSpring USA). The effective date was January 1, 2004 with an execution date May 20, 2004.

- HealthSpring USA and Manager mutually desire an arrangement that facilitates the management and administration of claims processing and information technology business operations of HealthSpring of Alabama

(HMO) which is the health maintenance organization that has contracted with Manager for the provision of all management functions.

- Manager desires to engage HealthSpring USA to provide such management and administrative services as are necessary and appropriate for the administration of HMO's Alabama business;
- 2.2- Authority- HealthSpring USA shall have the responsibility and commensurate authority to provide management and administrative services for HealthSpring of Alabama, including, without limitation, the management of risks that HealthSpring has undertaken as third party providers and the negotiation, monitoring and the quality assurance of contracts with third party providers. HealthSpring USA shall provide support services, personnel, administration of claims processing and adjudication, data processing, and other business office services as necessary. Manager is expressly authorized to provide such services in any reasonable manner Manager deems appropriate to meet the day-to-day requirements of the business functions of HealthSpring of Alabama in accordance with Alabama law, rule or regulation.
- 3.33- HealthSpring USA Personnel-
  - 3.3.1- Management Personnel- HealthSpring USA shall employ and otherwise retain, at HealthSpring USA's expense, and shall be responsible for selecting, training, supervising and terminating all personnel of HealthSpring USA deems reasonably necessary and appropriate for performance of its duties and obligations under this agreement. HealthSpring USA shall have sole responsibility for determining the salaries and benefits of all such management and administrative personnel, for paying such salaries and providing such benefits, and for withholding, as required by law, any sums for income tax, unemployment insurance, social security, or any other withholding required by applicable law or governmental requirement.
- 3.4- Administration of Funds- HealthSpring USA shall have access to the HMO account, to the extent necessary to issue claims payments on the HMO's claims. Such account shall be maintained at the bank in Alabama selected by Manager and approved by HealthSpring of Alabama.
- 3.5.1- Accounting and Financial records- Manager shall establish and administer accounting procedures, controls, and systems for development, preparation and safekeeping of records and books of account relating to the provision of services under this agreement.
- 4.2- Manager's Insurance- Throughout the Term, Manager shall, at Manager's expense, obtain and maintain with commercial carriers, self-insurance or some combination of these appropriate workers' compensation

coverage for Manager's employed personnel, if any, provided pursuant to this agreement, and casualty and comprehensive general liability insurance covering Manager, Manager's personnel and all of Manager's equipment in such amounts, on such basis and upon such terms and conditions as the Manager's Board deems appropriate.

- 5.1- Expenses- HealthSpring USA shall pay the expenses and disbursements in connection with provision of its services except as otherwise set forth in this agreement. HealthSpring of Alabama, the Alabama Department of Public Health, and/or Alabama Dept of Insurance or their designee shall have access to reports as necessary to ensure all expenses being charged to the Manager and subsequently the HMO are appropriate and supported by relevant detail.
- 5.2- Management fees- Manager agrees to pay to HealthSpring USA a monthly management fee equating to the direct costs for the administration of services of HealthSpring USA for the previous month as detailed on a report with sufficient detail to reflect the costs by the 10th day of each month.
- 6.1- Initial and renewal term- The term of this agreement will be for an initial period of one year and shall be automatically renewed for 1 year periods thereafter unless either party gives 120 day advance written notice of cancellation.
- 6.2- Termination-
  - 6.2.2- Termination on notice for default- If either party defaults in the performance of any obligation under this agreement, the other party shall provide written notice detailing such default. The defaulting party shall have 30 days, or 10 days in the event of nonpayment of fees, following the giving of written notice of such default by the other party, to cure the default.
- 8.1- Independent relationship- It is mutually understood and agreed that HealthSpring USA and Manager are at all times acting and performing as independent contractors with respect to each other, and nothing in this agreement is intended and nothing shall be construed to create an employer/employee, partnership or joint venture relationship.

The examiner noted that the Company's Board minutes did not reflect the approval or ratification of its management service agreement.

EMPLOYEE WELFARE

All individuals who performed administrative and operational functions for the Company were employees of NewQuest Management of Alabama, LLC. These employees were offered the following benefits:

Paid Time Off (Personal Vacation Days and Sick Days)
Holidays
Bereavement Leave
Civic Responsibilities
Family and Medical Leave
Health and Dental Plans
Basic Group Life Insurance
401(k) Plan
Employee Assistance Program
Short and Long Term Disability
Dependent Care Spending Account
Education Benefits

FIDELITY BOND AND OTHER INSURANCE

The Company was insured by a Financial Institution bond issued by Travelers Casualty and Surety of America at December 31, 2004 for an amount, which met the suggested minimum requirements of the NAIC Financial Condition Examiners' Handbook. The bond provided dishonesty and fraud coverage for all employees of the Company.

In addition to the above coverage, the Company was insured under the following policies at December 31, 2004:

Executive Safeguard Policy
Workers Compensation Policy

The coverage and limits carried by Company were reviewed during the course of the examination and appeared to adequately protect the Company's interests at the examination date.

REINSURANCE

Assumed Reinsurance

The Company did not assume any reinsurance during the examination period.

Ceded Reinsurance

During the course of this examination, the agreement in effect was reviewed with regard to type, limits, and pertinent safeguards. The Company ceded reinsurance under an Excess HMO Reinsurance Agreement with Employers Reinsurance Corporation (ERC). The following reinsurance contract was applicable at December 31, 2004.

Terms of Coverage	12 months at January 1, 2004
Coverage	Commercial business
Limits on Coverage	\$2,000,000 per member per year in excess of \$175,000 per member per year.

The reinsurance contract contained an insolvency clause, which provided for reinsurance payments to a receiver or statutory successor without diminution because of the insolvency of the reinsured. There was also a Parental Guarantee between the Company's parent, NewQuest, LLC and ERC whereby NewQuest agreed that if the Company failed to perform its continuation of benefits obligations to its members due to insolvency, NewQuest would, immediately and without demand from ERC, satisfy the obligations of the Company.

No reserve credits were taken for reinsurance ceded by the Company during the examination period

The Company did not disclose the required information for reinsurance in its 2004 Notes to the Financial Statement in accordance with the NAIC Annual Statement Instructions and the NAIC Accounting Practices and Procedures Manual- SSAP No. 61, paragraph 60 by completing the general interrogatories for reinsurance. The Company also did not complete the appropriate reinsurance schedules (Schedule S) nor did it report the reinsurance numbers in the exhibits in its 2004 Annual Statement in accordance with the NAIC Annual Statement Instructions.

MARKET CONDUCT

The Alabama Department of Public Health (ADPH) regulated most aspects of the Company's relations and dealings with its customers. ADPH conducted a two-year survey of the Company, which was dated February 14, 2002. The survey report issued by ADPH reflected some deficiencies, which were not determined to have an adverse affect on or indicate misstatement of any financial account balances or significant non-compliance with Alabama Department of Insurance statutes or regulations.

Advertising and Marketing

The Company had a formal advertising program as of December 31, 2004. During the examination period, the Company's advertising program was limited to printed sales brochures provided for distribution via its agency force, a website that was accessible by the public, and two television commercials. Currently, the Company has made the strategic decision to primarily focus on its Medicare Advantage product.

Complaint Handling

The Company recorded complaints that were reported to the Alabama Department of Insurance, Alabama Department of Public Health and complaints that were reported directly to the Company. A total of nine complaints were received from regulatory agencies. The examiners reviewed these nine complaints to determine the adequacy of documentation, the timeliness of the Company's response and the adequacy of the steps to finalize and dispose of the complaint. It was determined that the Company took over ten business days to respond to three of the Departmental complaints, which was not in accordance with Alabama Department of Insurance Bulletin dated June 18, 1990. According to this bulletin, "This bulletin shall serve as notice that complaints and inquiries from the Department of Insurance to insurance companies shall be answered within ten (10) business days after receipt thereof."

The examiners also reviewed a sample of fifty complaints that were consumer direct complaints and/or grievances out of a population of 459. The examiners reviewed this sample to determine the adequacy of documentation, the timeliness of the Company's response and the adequacy of the steps to finalize and dispose of the complaint. As noted in the prior examination, this examination also determined that the Company did not provide its complainants with contact information for the Alabama Department of Insurance- Consumer Division in accordance with the NAIC's Market Conduct Examiner's Handbook, Complaint Handling, Standard 2.

Claims Handling Practices

The Company made a decision in late 2003 to migrate its claims processing from the Amisys system to the Managed Health Care System (MHC). During 2004, claims with dates of service on or after January 1, 2004 were paid from the Nashville, Tennessee office. Claims with dates of service prior to that date were processed locally from the Amisys system. As of December 31, 2004, the Amisys system was shut down, and all claims are currently paid through MHC.

A sample 84 MHC Claims and 16 Amisys claims were reviewed to determine if the change in claims processing systems had an effect on the Company's ability to efficiently process claims. A test of timeliness of payments and the adequacy of claims documentation was used to evaluate the change in the process between the two systems. The change was determined to have no effect on the Company's ability to efficiently process claims.

A sample of 100 2004 paid claims and 100 2004 closed without payment claim files were reviewed in order to evaluate the Company's compliance with policy provisions, the timeliness of paying claims, and the adequacy of claims documentation. After the review of this sample, it was determined that the claims were paid or were closed without payment in accordance with policy provisions, that claims were paid in a timely manner, and that adequate claims documentation was maintained.

Compliance with ALA ADMIN CODE 482-1-122 (2001)

This Regulation governs the treatment of nonpublic personal financial information about individuals by all licensees of the Alabama Department of Insurance. This Regulation requires a licensee to provide notice to individuals about its privacy policies and practices; describes the conditions under which a licensee may disclose nonpublic personal financial information about individuals to affiliates and nonaffiliated parties; and, provides methods for individuals to prevent a licensee from disclosing that information.

The Company sends an initial notice to new business policyholders and annually thereafter. The Company provided notices to its customers that indicated the types of information collected, the way it is used and the manner of collection.

The notice also informed the customer that the Company reserves the right to disclose information to affiliated and nonaffiliated third parties.

The privacy form contained a *Notice of Privacy Practices,* which emphasized and explained the Company's policies. These principles followed the guidelines established in ALA ADMIN CODE 482-1-122-.07 (2001) concerning the information to be included in privacy notices.

The Company does not share customer and/or consumer personal information with any nonaffiliated third parties except those permitted under Section 14, 15 and 16 of the ALA ADMIN CODE 482-1-122 (2001), which defines exceptions to limits on disclosures. Access to nonpublic personal information is restricted when the insured chooses to opt out. The Company had controls and guidelines in place for employees and producers on how to handle any consumer's nonpublic personal financial, health or medical information.

Territory

The Company was licensed to transact business in the State of Alabama at December 31, 2004. There were no pending applications at December 31, 2004. The Company was allowed to market its products in the following counties:

Autauga, Baldwin, Bibb, Blount, Bullock, Calhoun, Cherokee, Chilton, Clarke, Coosa, Cullman, Dallas, Dekalb, Elmore, Etowah, Fayette, Jefferson, Lawrence, Lowndes, Macon, Madison, Marion, Marshall, Mobile, Monroe, Montgomery, Morgan, Pickens, Russell, Shelby, St. Clair, Talladega, Tuscaloosa, Walker, Washington, and Winston.

Plan of Operation / Compliance with Agents' Licensing Requirements

The Company made the operational decision to shift its primary focus of business to its Medicare Advantage product lines. This decision was based on a number of factors, mainly the slow down in small and individual commercial business. The Company discontinued offering commercial benefits to individuals and small group employers in Alabama effective June 1, 2006.

At December 31, 2004, the Company used various agents/brokers and agencies to sell its products. All agents/brokers were licensed by the Alabama Department of Insurance. Only licensed agents were used to sell its policies across the state of Alabama. The total number of agents the Company had licensed at December 31, 2004 was 375. The agents were paid commissions based on the number of policies they wrote.

The detail for the 2004 commissions paid to agents totaled $2,136,352, and the amount reported in the Company's 2004 Annual Statement- Underwriting and Investment Exhibit- Part 3 was $2,238,986. A difference of $102,634.11 was noted. Not maintaining records comprising the amounts in its 2004 Annual statement was not in accordance with ALA. ADMIN. CODE 482-1-079. -015, which states:

"An Alabama domiciled (domestic) MHO shall keep all necessary records in an Alabama location for the efficient examination of its financial condition health care delivery system. ...Every domestic HMO shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transaction, and affairs in accordance with such methods and system as are customary or suitable as to the kind, or kinds, of business transacted."

An inspection of Company records was conducted by the examiners to determine that producers representing the Company in Alabama were appropriately appointed. A register of licensed agents was obtained from the Agents' Licensing Division of the Alabama Department of Insurance and was compared to a current list of agents provided by the Company.

Individual terminated producer files were reviewed to determine if the Company maintains the reason for termination. During the review of 50 terminated producer files from a population of 83, it was determined that the Company did not contain documentation of the reason for termination for 25 terminated agents. There was also no documentation of the notice of termination that was mailed to the Alabama Department of Insurance to be in accordance with ALA. CODE § 27-7-30(e) (1975), which states:

"Subject to the producer's contract rights, if any an insurer or authorized representative of the insurer may terminate a producer's appointment at any time. An insurer or authorized representative of the insurer that terminates the appointment, employment, or contract with a producer for any reason shall within 30 days following the effective date of the termination, using a format prescribed by the commissioner, give notice of the termination to the commissioner."

Not maintaining this documentation was not in accordance with ALA ADMIN. CODE 482 -1-079-.15, which states:

"...Every domestic HMO shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions, and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of business transacted."

Policy Forms and Underwriting Practices

The Company's underwriting manual outlined the products available and the guidelines used to sell the Company's products, which included definitions of eligible groups, group size, eligible employees, other group eligibility criteria, pre-existing conditions, participation requirements for small groups, and individuals.

The Company submitted numerous policy form and rate filings during the examination period. All were approved by the Alabama Department of Insurance.

ACCOUNTS AND RECORDS

The Company changed its claims and premium system from Amisys to MHC (Managed Healthcare) during the examination period. Also, effective January 1, 2004, the Company transitioned a number of its operational departments including claims processing and information systems to the HealthSpring, Inc. corporate office in Nashville, Tennessee. This operational shift was approved by the Alabama Department of Insurance on June 10, 2004.

The Company was audited annually by the independent certified public accounting (CPA) firm of KPMG, LLP, Nashville, Tennessee, which conducted the Company's audits for the three-year period covered by this examination. No management letters were generated by the CPAs for the examination period.

The Company's reserve calculations for the three-year period under examination were certified by David L. Terry, Jr., A.S.A., M.A.A.A. of NewQuest, LLC.

The Company indicated in response to the ISQ questionnaire that the Company did not have insurance on e-business transactions. COMPANY OPERATIONS/MANAGEMENT Standard 2, of the NAIC's Market Conduct

Examiners Handbook requires that the Company has appropriate controls, safeguards and procedures for protecting the integrity of computer information.

The Company indicated it did not have a disaster recovery plan that encompassed recovery of the Wide Area Network. COMPANY OPERATIONS/MANAGEMENT Standard 2, of the NAIC's Market Conduct Examiners Handbook requires that the Company has appropriate controls, safeguards and procedures for protecting the integrity of computer information.

The Company's Information System Management indicated that the Company has not tested its business contingency plan to insure all significant business activities work properly.

The Company did not provide or maintain certain detailed records as of year-end. Consequently, the reconciliation of various records caused the examiners' documentation reviews to progress slowly. Also, the Company did not always provide requested information within ten working days, as is required by Section 6 of Alabama Department of Insurance Regulation No. 118, which states:

"The insurer shall provide, within ten (10) working days, any record or response requested in writing by any duly appointed deputy, assistant, employee or examiner of the commissioner."

This was also noted in the prior examination report.

Some of the requested supporting documentation was not maintained by the Company, which was not in accordance with ALA. ADMIN. CODE 482-1-079-.15 (1987) that states:

"Every domestic HMO shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions, and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of business transacted."

This was also noted in the prior examination report.

The Company hired consultants with Pearce, Bevill, Leesburg and Moore, PC, Birmingham, Alabama and Taylor Chandler, LLC, Montgomery, Alabama to help expedite providing the requested information to the examiners.

The Company's accounting department was mainly responsible for maintaining the accounting records including the general ledger and supporting ledgers. It was also responsible for the accounting of the Company's investments, assets and liabilities, processing accounts payable checks, collecting receivables, and preparing and filing the Company's financial statements.

The Company incorrectly included the change in its 2003 to 2004 premium deficiency reserve in its Net Premium Income line item in its 2004 Statement of Revenue and Expenses instead of in the Increase in Reserves for Life and Accident and Health Contracts line in accordance with the NAIC Annual Statement Instructions. This misclassification had no impact on the Company's financial statements.

FINANCIAL STATEMENTS

Financial statements included in this report, which reflect the financial condition of the Company at December 31, 2004, and its operations for the years under examination, consist of the following:

THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.

HEALTHSPRING OF ALABAMA, INC.
STATEMENT OF ASSETS
For the Year Ended December 31, 2004

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds **(Note 1)**	$ 6,996,671	$ 0	$ 6,996,671
Cash ($13,496,148) **(Note 2)**, cash equivalents ($900,000) and short-term investments ($1,983,770)	16,379,917	0	16,379,917
Subtotals, cash and invested assets	$23,376,588	$ 0	$23,376,588
Investment income due and accrued **(Note 3)**	138,986	0	138,986
Uncollected premiums and agents' balances in the course of collection **(Note 4)**	1,959,851	0	1,959,851
Net deferred tax asset **(Note 5)**	0		0
Receivables from parent, subsidiaries and affiliates **(Note 6)**	140,834	140,834	0
Healthcare and other amounts receivable **(Note 7)**	173,934	109,609	64,325
Other assets nonadmitted	2,519,733	2,519,733	0
Aggregate write-ins for other than invested assets	0	0	0
Total assets	$28,309,926	$2,770,176	$25,539,750

THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN THIS REPORT ARE AN INTEGRAL PART THEREOF.

HEALTHSPRING OF ALABAMA, INC.
STATEMENT OF LIABILITES, CAPITAL AND SURPLUS
For the Year Ended December 31, 2004

	Covered	Uncovered	Total
Claims unpaid (Note 8)	$13,599,308	$1,802,320	$15,401,628
Accrued medical incentive pool and bonus (Note 9)	0	49,844	49,844
Unpaid claims adjustment expenses	0	247,000	247,000
Aggregate health policy reserves (Note 10)	0	1,400,000	1,400,000
Premiums received in advance	104,390	0	104,390
General expenses due and accrued (Note 11)	0	505,878	505,878
Current foreign and federal income tax payable		1,042,157	1,042,157
Amounts withheld or retained for the account of others (Note 12)	0	0	0
Amounts due to parent, subsidiaries and affiliates	510,970	0	510,970
Total Liabilities	$14,214,668	$5,047,199	$19,261,867
Capital and Surplus			
Common capital stock			$ 112,400
Gross paid in and contributed surplus (Note 13)			7,540,236
Unassigned funds (surplus) (Note 14)			-1,374,754
Total capital and surplus			$ 6,277,882
Total liabilities, capital and surplus			$25,539,749

THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN THIS REPORT ARE AN INTEGRAL PART THEREOF.

HEALTHSPRING OF ALABAMA, INC.
STATEMENT OF REVENUE AND EXPENSES
For the Years Ended December 31, 2004, 2003 and 2002

	2004	2003	2002
MEMBER MONTHS	340,427	318,008	348,480
Net premium income	$134,978,713	$93,930,820	$88,511,502
Total revenues	$134,978,713	$93,930,820	$88,511,502
Medical and Hospital:			
Hospital/medical benefits	$ 98,890,772	$64,731,155	$64,130,447
Outside referrals	0	489,551	541,784
Emergency room and out-of-area	0	2,735,733	2,970,031
Prescription drugs	9,364,929	9,547,883	9,710,574
Subtotal	$108,255,701	$77,504,322	$77,352,836
Less:			
Net reinsurance recoveries	$ 74,095	$ 82,814	$ 461,878
Total hospital and medical	$108,181,606	$77,421,508	$76,890,958
Claim adjustment expenses, including $1,334,400 cost containment expenses	$ 8,264,762	$ 3,876,418	$ 3,822,184
General administration expenses	13,244,712	11,102,096	12,047,099
Increase in reserves for life and accident and health contracts	1,400,000	0	0
Total underwriting deductions	$131,091,080	$92,400,022	$92,760,241
Net underwriting gain or (loss)	$ 3,887,663	$ 1,530,798	$ -4,248,739
Net investment income earned	$ 230,678	$ 121,199	$ 180,407
Net realized capital gains or (losses)	0	0	-4,525
Net investment gains or (losses)	$ 230,678	$ 121,199	$ 175,882
Aggregate write-ins for other income or expenses	402,443	-402,443	2,500,000
Federal and foreign income taxes incurred	2,249,965	407,230	0
Net income (loss)	$ 2,270,789	$ 842,324	$ -1,572,857

THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN THIS REPORT ARE AN INTERGRAL PART THEREOF.

HEALTHSPRING OF ALABAMA, INC.
STATEMENT OF CHANGES IN CAPITAL AND SURPLUS
For the Years Ended December 31, 2004, 2003 and 2002

	2004	2003	2002
Capital and surplus prior reporting year	$3,972,424	$2,242,069	$ -612,029
GAINS AND LOSSES TO CAPITAL & SURPLUS:			
Net income or (loss)	$2,270,789	$ 842,324	$-1,572,857
Net unrealized capital gains and losses	0	0	-4,524
Change in nonadmitted assets	34,668	888,031	1,087,492
Change in surplus notes	0	0	-1,500,000
Capital changes:			
Paid in	0	0	4,843,987
Net change in capital and surplus	$2,305,457	$1,730,355	$ 2,854,098
Capital and surplus end of reporting year	$6,277,881	$3,972,424	$ 2,242,069

THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN THIS REPORT ARE AN INTERGRAL PART THEREOF.

NOTES TO THE FINANCIAL STATEMENTS

Note 1 – Bonds $ 6,996,671

The captioned amount is the same as reported by the Company in its 2004 Annual Statement.

The Company reported NAIC designations of ones in its 2004 Annual Statement, Schedule D - Part 1, column 6 for 22 bonds that were not U.S. Government Issued and had ratings from a NRSRO; however, these securities should have been reported as 1FE in accordance with the NAIC's Purposes and Procedures Manual of the Securities Valuation Office.

The Company did not maintain purchase advices for its investment transactions during the period under examination. This was noted in the prior examination report. According to a Company official, the investment bank statements were used to enter bond purchases into the general ledger. In accordance with ALA ADMIN CODE 482-1-079-.15 (1987), "Every domestic HMO shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions, and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds of business transacted."

Note 2- Cash $13,496,148

The captioned amount is the same as reported by the Company in its 2004 Annual Statement.

The Company did not perform bank reconciliations for each of its AmSouth Bank accounts separately. These bank accounts were reconciled as though they were one account. This was noted in the prior two examination reports.

With regards to the Company's repurchase account, the fair value of the Company's collateral, at December 31, 2004, was 100% of the purchase price and not 102% as is required by SSAP No. 45, paragraph 8 (a), which states:

"The reporting entity shall receive as collateral transferred securities having a fair value at least equal to 102 percent of the purchase price..."

The Company's repurchase agreement with AmSouth Bank did however require that the fair value of the underlying collateral be 102% of the purchase price.

The Company reported its repurchase agreement net of the Company's cash account on Schedule E - Part 1 at December 31, 2004. However, according to the NAIC Annual Statement Instructions and the NAIC Accounting Practices and Procedures Manual- SSAP No. 45, paragraph 4, the Company was to report repurchase agreements on Schedule DA - Part 1 as a short-term investment. This misclassification had no effect on the Company's surplus.

Note 3 - Investment income due and accrued **$138,986**

The captioned amount is the same as reported by the Company in its 2004 Annual Statement.

The 2004 due and accrued interest totals from Schedule D-Part 1, Schedule DA -Part 1, Schedule E -Part 1 and Schedule E- Part 2 equaled $379,069, which did not tie to the Company's 2004 Annual Statement- balance sheet (captioned amount above). The Company incorrectly reported total year-to-date paid and accrued interest in the "due and accrued income" columns for the aforementioned schedules instead of accrued interest only in accordance with the NAIC Annual Statement Instructions. The Investment income due and accrued asset did not contain the year-to-date paid interest. Reporting errors for this asset were also noted in the prior examination report.

Note 4- Uncollected premiums and agents' balances in the course of collection **$1,959,851**

The captioned amount is the same as reported by the Company in its 2004 Annual Statement.

The Company could not provide the detail for billing discrepancies for one of its groups totaling $84,969, which was not in compliance with ALA. ADMIN. CODE 482-1-079-.15. According to the aforementioned regulation,

"An Alabama domiciled (domestic) HMO shall keep all necessary records in an Alabama location required for the efficient examination of its financial condition and health care delivery system. ...Every domestic HMO shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions, and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of business transacted."

The $84,969 was included in the Allowance for bad debt and retroactivity, which reduced the admitted asset at December 31, 2004.

<u>Note 5- Net deferred tax asset</u> **<u>$0</u>**

The captioned amount is the same as reported by the Company in its 2004 Annual Statement.

The financial statements located within the Company's CPAs' 2004 Audit Report reflected a deferred tax asset in the amount of $366,398, which was not reflected within the Company's 2004 Annual Statement. Documentation supporting this amount was provided. The Company however did not amend its 2004 Annual Statement to reflect this change.

<u>Note 6- Receivable from parent, subsidiaries and affiliates</u> **<u>$0</u>**

The captioned amount is the same as reported by the Company in its 2004 Annual Statement.

This line item was comprised of a nonadmitted receivable amount of $140,834 due from the Company's parent, NewQuest, LLC. It was a 2002 rent and lease netted intercompany expense and was nonadmitted because it was over ninety days past due. However as noted in the prior examination report, the Company was again not in compliance with ALA. Code § 27-41-36(a) (1975), which states: "...an insurer shall not invest in nor lend its funds upon the security of any note or other evidence of indebtedness of any director, officer or controlling stockholder of the insurer..." This balance was settled in June 2006.

<u>Note 7- Healthcare and other amounts receivable</u> **<u>$64,325</u>**

The captioned amount is the same as reported by the Company in its 2004 Annual Statement.

At December 31, 2004, this asset was comprised of pharmacy rebate receivables. The Company was calculating these rebates incorrectly. According to the contract, the guaranteed rebate was a specified amount per prescription drug claim; however, the Company was calculating the rebate per member. The difference in the admitted amount resulted in an immaterial difference of $84,809, which understated this asset by this amount.

Note 8- Claims unpaid **$15,401,628**

The captioned amount is the same as reported by the Company in its 2004 Annual Statement.

During the review of a sample of seventy-six negative 2004 claims paid, the Company did not provide an explanation for one negative claim in the amount of $47.11. The Company issued the check on April 15, 1998 and voided it on April 8, 2004. According to the claims department, accounting was cleaning up the outstanding checks by contacting individuals (providers) to either reissue the checks or escheat the outstanding checks to the State. However, for this claim, it was not escheated nor was it reissued to the provider. The Company could not explain why this check was not reissued. Representation was made that it was not the Company's intention to exclude this or any other amount from the unclaimed property reports and that it will include this disbursement in the next unclaimed property remittance.

The Company does not incorporate reinsurance recoveries in the lag factor development for IBNR calculations. This was also noted in the prior examination. According to Company management, the IBNR reserve models reflect a conservative approach to calculating claims reserves and reinsurance recoveries are reflected as a reduction of medical expense in the month received. Anticipated recoveries on claims incurred but not reported were therefore not included in the claim liability. To be accurately reflected in the liability calculation, such recoveries should be allocated to the incurral month of the claim. Reinsurance recoveries were determined to be immaterial for the examination period; therefore, no changes were made to reflect this omission.

The last examination report recommended that the Company complete the final accounting of its capitation contracts, which were terminated as of February 28, 2002, and settle all balances owed. For these three contracts, the Company provided documentation of the settlement for one of these contracts, which was a cash receipt. Canceled checks and bank statements showing the settlements to the other two terminated capitated providers was not provided, which was not in accordance with ALA. ADMIN. CODE 482-1-079. -015. According to this regulation,

> "An Alabama domiciled (domestic) MHO shall keep all necessary records in an Alabama location for the efficient examination of its financial condition health care delivery system. ...Every domestic HMO shall have, and maintain, its principal place of business and home office in this state

and shall keep therein complete records of its assets, transactions, and affairs in accordance with such methods and system as are customary or suitable as to the kind, or kinds, of business transacted."

Note 9- Accrued Medical Incentive Pool **$49,844**

The captioned amount is the same as reported by the Company in its 2004 Annual Statement.

The Company did not provide a calculation for the amount reported as accrued medical incentive pool at the examination date. In discussions with the Company, it was determined that the amount of $49,844 was incorrect. The correct amount should have been $39,826. However, the Company was unable to provide the backup to how either the $49,844 or the $39,826 was actually determined (difference was $10,018 deemed immaterial). The Company did provide a year-to-date reconciliation for the dates of service from December 2004 to April 2005, which did demonstrate the calculation of the incentive bonus for those dates. It was verified by the examination actuary that the $39,826 was actually paid out during 2005. The Company is required to maintain adequate records in accordance with ALA. ADMIN. CODE 482-1-079-.15(1987)

> "Every domestic HMO shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions, and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of business transacted."

Note 10- Aggregate health policy reserves **$1,400,000**

The captioned amount is $1,400,000 more than the $0 reported in the Company's 2004 Annual Statement.

The Company did not record a premium deficiency reserve at December 31, 2004. The Company had a loss in the commercial line of $2,592,661 for 2004. The losses on the commercial line continued through 2005 during which the commercial line had a loss of $1,361,164. At the end of 2005, the Company made the operational decision to shift its primary focus of business to its Medicare Advantage product lines with a discontinuance of commercial benefits offered to individuals and small group employers in Alabama effective June 1, 2006. Prior to June 1, 2006, small employer groups currently enrolled in the

Company's commercial plans may elect to continue to participate in the Company's plans through April 30, 2007. The Company wrote only a few small commercial groups in 2005, so the losses arising in 2005 were attributable to commercial business in force at the end of 2004. Thus, a premium deficiency reserve would be required for 2004 in accordance with SSAP No. 54, paragraph 18 and the Health Reserves Guidance Manual. Group business is yearly renewable, therefore, the actuarial examiner set up a premium deficiency reserve in the amount of the loss in 2005, plus a small amount for conservatism resulting in $1,400,000.

<u>Note 11- General expenses due or accrued</u> **<u>$505,878</u>**

The captioned amount is the same as reported by the Company in its 2004 Annual Statement.

The Company included an accrued premium tax payable of $193,817 in its December 31, 2004 general expenses due or accrued. The examiner recalculated the Company's 2004 Alabama premium taxes and determined that the Company overpaid its premium taxes by $52,697. The Company should not have included an accrued premium tax payable and therefore overstated its general expenses due or accrued liability at December 31, 2004 by $193,817. The Company should evaluate its premium taxes and establish appropriate premium tax accruals, if needed, in future financial statements.

<u>Note 12- Amounts withheld or retained for the account of others</u> **<u>$-0-</u>**

The captioned amount is the same as reported by the Company in its 2004 Annual Statement.

The Company did not file its unclaimed property report for 2004 by the first of November 2004 in accordance with ALA. CODE §35-12-76 (c) (2004), which states:

"The report shall be filed before November 1 of each year and cover the 12 months next preceding July of that year."

The Company also did not escheat two outstanding check disbursements, issued in August 1997 and in April 1998, to the State Treasurer in accordance with ALA. CODE §35-12-72 (2004), which states:

"(a) Property is presumed abandoned if it is unclaimed by the apparent owner during the time set forth below for the particular property:...(18) All other property, three years after the owner's right to demand the property or after the obligation to pay or distribute the property arises, whichever first occurs."

Noncompliance with escheat laws was noted in the prior examination report.

<u>Note 13- Gross paid in and contributed surplus</u> **<u>$7,540,236</u>**

The captioned amount is the same as reported by the Company in its 2004 Annual Statement.

The Company did not keep documentation of its 2002 paid in capital transaction in the amount of $89,986,318 in accordance with ALA ADMIN. CODE 482-1-079-.15, which requires the following:

"An Alabama domiciled (domestic) HMO shall keep all necessary records in an Alabama location for the examination of its financial condition health care delivery system. ...Every domestic HMO shall have, and maintain, its place of business and home office in this state and shall keep therein complete records of its assets, transaction, and affairs in accordance with such methods and system as are customary or suitable as to the kind, or kinds of business transacted."

According to Company management, this transaction was done in error and was reversed; therefore, this had no effect on the Company's surplus in 2002.

<u>Note 14 - Unassigned funds (surplus)</u> **<u>-$1,374,754</u>**

The unassigned funds (surplus) balance of the Company, as determined by this examination, was $1,400,000 less than the $25,246 reported by the Company in its 2004 Annual Statement. The following presents a reconciliation of unassigned funds per the Company's filed Annual Statement to that developed by this examination:

Unassigned funds balance per Company		**$25,246**
Examination (increase)/ decrease to liabilities:		
Aggregate health policy reserves	**-$1,400,000**	
Total increase to liabilities		**-$1,400,000**
Unassigned fund balance per Examination		**-$1,374,754**

SUBSEQUENT EVENTS

HealthSpring, Inc. was formed in October 2004 in connection with a recapitalization transaction which was accounted for using the purchase method, involving the Company's parent, NewQuest, LLC, its members, GTCR Golden Rauner II, L.L.C. , a private equity firm, and its' related funds, or the GTCR Funds, and certain other investors and lenders. The recapitalization was completed in March 2005.

Currently, the Company is owned 100% by NewQuest, LLC. NewQuest, LLC is owned 100% by HealthSpring, Inc. HealthSpring, Inc. issued an initial public offering on February 8, 2006 and is listed under the symbol HS on the New York Stock Exchange. In connection with the initial public offering, HealthSpring, Inc. sold 10.6 million shares of common stock at a price of $19.50 per share. The total proceeds to HealthSpring, Inc. were $188.7 million, net of the $18.0 million of offering costs. From the offering and available cash, HealthSpring, Inc. repaid all of its long-term debt and accrued interest, including a $1.1 prepayment penalty, totaling $189.9 million. Additionally, HealthSpring, Inc. issued approximately 12.6 million shares of common stock in exchange for all of the outstanding preferred stock, including dividends.

At the end of 2005, the Company made the operational decision to shift its primary focus of business to its Medicare Advantage product lines with a discontinuance of commercial benefits offered to individuals and small group employers in Alabama effective June 1, 2006. Prior to June 1, 2006, small employer groups currently enrolled in the Company's commercial plans may elect to continue participating in the Company's plans through April 30, 2007.

Subsequent to the examination date, the Company was named as a defendant in three lawsuits in the Circuit Court of Wilcox County, Alabama, arising out the marketing of the Company's Medicare Advantage product, Seniors First. The plaintiffs in all three cases are represented by common counsel, and the complaints are nearly identical. See "CONTINGENT LIABILITIES AND PENDING LITIGATION" below for further commentary.

CONTINGENT LIABILITIES AND PENDING LITIGATION

The review of contingent liabilities and pending litigation included an inspection of representations made by management and the Company's legal counsel and a general review of the Company's records and files conducted during the examination, including a review of claims. The only item noted was the disclosure regarding three pending lawsuits subsequent to the examination date.

The Company is defending three lawsuits currently pending in the Circuit Court of Wilcox County, Alabama, arising out of the marketing of the Company's Medicare Advantage product, Seniors First. The plaintiffs in all three cases are represented by common counsel, and the complaints are nearly identical.

The complaints name as defendants both the Company and the independently contracted sales representatives, who enrolled the plaintiffs into Seniors First. While asserting a number of state law theories, the allegations focus on two primary claims: (1) alleged misrepresentations by the sales representatives in enrolling the plaintiffs into Seniors First; and (2) alleged negligence and/or wantonness in the hiring, training and supervision of the sales representatives. The Company has filed answers in all three cases, denying all wrongdoing and asserting various affirmative defenses. The Company intends to vigorously defend these lawsuits.

The sales representatives each have answered the respective complaints against them and also have asserted cross-claims against the Company. In their answers, the sales representatives generally denied the plaintiffs' allegations regarding the misrepresentations set out above. However, in the cross-claims, the sales representatives allege that all representations made by them were directed by the Company and were in accordance with the training they received from the Company. The Company has filed answers to the cross-claims in all three cases, denying liability and asserting affirmative defenses and intends to vigorously defend the cross-claim allegations.

The Pending Litigation is in the early stages. The parties have exchanged paper discovery. Due to the unpredictable nature of litigation, the Company and its attorneys have deemed it is impossible to evaluate the likelihood of an unfavorable outcome or to estimate the amount or range of potential loss.

COMPLIANCE WITH PREVIOUS RECOMMENDATIONS

A review was conducted during the current examination with regards to the Company's compliance with the recommendations made in the previous examination report. This review indicated that the Company had satisfactorily complied with the prior recommendations, with the exception of the following:

Committees

During the prior examination, it was recommended that the Company's board of directors select members of its committees in accordance with Article IV Section 1 of its By-laws. During this examination, the Company's Board's minutes did not reflect the selection of committee members. See "Committees" on page 10 for further comment.

Complaint Handling

The prior examination report recommended that the Company provide its enrollees with contact information for the Alabama Department of Insurance, Consumer Division when complaints are made, in accordance with the NAIC Market Conduct Examiners Handbook- Complaint Handling, Standard 2. During this examination, the Company did not provide its enrollees with contact information for the Alabama Department of Insurance, Consumer Division. See "Complaints Handling" on page 25 for further detail.

ACCOUNTS AND RECORDS

The prior examination recommended that the Company maintain complete and accurate records in its Alabama home office in accordance with ALA. CODE § 27-27-29(a) (1975). During this examination, the Company did not maintain complete and accurate records of its assets, transactions and affairs in accordance with ALA. ADMIN. CODE 482-1-079-.15 (1987) that states:

"Every domestic HMO shall have, and maintain, its principal place of business and home office in this state, and shall keep therein complete records of its assets, transactions, and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of business transacted."

During the prior examination, it was also recommended that the Company comply with Alabama Department of Insurance Regulation No. 118, by providing responses within ten working days regarding information requested by personnel representing the Alabama Department of Insurance. During this examination, the Company did not respond or provide all information within ten working days.

Bonds

1. During the prior examination, the following recommendations were made:
   a. It was recommended that the Company correctly complete Schedule D- Part 1, Schedule D- Part 3, and Schedule D- Part 4 in accordance with the NAIC Annual Statement Instructions-Health in its future financial filings.
   b. It was also recommended that the Company report the correct NAIC designations of its investments in the appropriate schedules in its future financial statements in accordance with the NAIC Annual Statement Instructions-Health and the NAIC SVO Purposes and Procedures Manual.
   c. It was recommended that the Company obtain from its custodian and maintain all documents pertaining to its securities transactions.

During this examination, the Company did not complete its 2004 Schedule D- Part 1 correctly, it did not report the correct NAIC designations in Schedule D- Part 1, nor did it maintain all documents pertaining to its security transactions. See "Note 1- Bonds" on page 37.

Cash

During the prior examination, it was recommended that the Company reconcile each bank account separately rather than having one reconciliation per bank and comply with Sections 35-12-23 and 35-12-31, Code of Alabama 1975, as amended, by remitting all unclaimed property over five years old with the Alabama State Treasurer.

During this examination, the Company did reconcile each bank account separately and did not comply with the escheat laws. See "Note 2- Cash" on page 37 and "Note 12- Amounts withheld or retained for the account of others" on page 42.

Receivable from parent, subsidiaries and affiliates

During the prior examination, it was recommended that the Company comply with the NAIC Annual Statement Instructions- Health when completing its organizational chart for Schedule Y- Part 1 in future financial filings and that the Company comply with ALA. Code § 27-41-36(a) (1975), which states: "...an insurer shall not invest in nor lend its funds upon the security of any note or other evidence of indebtedness of any director, officer or controlling stockholder of the insurer..." During this examination, the Company did not complete its Schedule Y- Part 1 in accordance with the NAIC Annual Statement Instructions and did not comply with ALA. Code § 27-41-36(a) (1975). See "Organizational Chart" on page 15 and "Note 6- Receivable from parent, subsidiaries and affiliates" on page 39.

Claims unpaid

During the prior examination, it was recommended that procedures be established to insure that, for the purposes of reporting claims by incurral month for developing lag factors, reinsurance recoveries should be allocated to the appropriate month of incurral. During this examination, the Company did not allocate its reinsurance recoveries to the appropriate month of incurral. See "Note 8- Claims unpaid" on page 40.

COMMENTS AND RECOMMENDATIONS

CORPORATE RECORDS – Page 8

It is recommended that all changes to the Articles of Incorporation and By-laws be approved by the Board of Directors.

It is recommended that the Company hold its annual shareholders meetings for the election of directors and the transaction of general business in January of each year in accordance with the Company By-laws.

It is recommended that the Company hold its annual Board of Directors meeting immediately following the annual shareholder's meeting in accordance with Company By-laws.

It is recommended that investments made by the Company be authorized, approved or ratified by the board of directors in accordance with ALA. CODE § 27-41-5 (1975), which states:

> "An insurer shall not make any investment or loan, other than loans on policies or annuity contracts, unless the same be authorized, approved or ratified by the board of directors of the insurer or by such committee…"

Committees – **Page 10**

It is recommended that the Company's board of directors select members of its committees in accordance with Article IV Section 1 of its By-laws.

Conflict of Interest – **Page 14**

It is again recommended that the Company have its officers, directors and responsible employees complete conflict of interest statements and maintain these statements.

It is also recommended that the Company correctly complete its general interrogatories in accordance with the NAIC Annual Statement Instructions for future financial filings.

Management and Service Agreements - **Page 17**

It is recommended that the Company's Board approve or ratify all agreements which the Company is a party thereto.

Ceded Reinsurance - **Page 20**

It is recommended that the Company disclose the required reinsurance information in the Notes to the Financial Statements in accordance with the NAIC Annual Statement Instructions and the NAIC Accounting Practices and Procedures Manual- SSAP No. 61, paragraph 60.

It is recommended that the Company report its reinsurance amounts in the appropriate exhibits and complete Schedule S in future financial statements in accordance with the NAIC Annual Statement Instructions.

Complaint Handling – **Page 25**

It is recommended that the Company respond to complaints in accordance with Alabama Bulletin dated June 18, 1990, requiring complaints and inquiries from the Department of Insurance to insurance companies be answered within ten business days after receipt thereof.

It is again recommended that the Company provide its enrollees with contact information for the Alabama Department of Insurance- Consumer Division, when complaints are made in accordance with NAIC's Market Conduct Examiner's Handbook, Complaint Handling, Standard 2.

Plan of Operation / Compliance with Agents' Licensing Requirements - Page 27

It recommended that the Company keep supporting documentation of its commissions detail in accordance with ALA. ADMIN. CODE 482-1-079-.15, which states:

> "An Alabama domiciled (domestic) MHO shall keep all necessary records in an Alabama location for the efficient examination of its financial condition health care delivery system. ...Every domestic HMO shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transaction, and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of business transacted."

It is recommended that the Company maintain documentation of termination notices that were mailed to terminated producers and the Alabama Department of Insurance in accordance with ALA ADMIN. CODE 482 -1-079-.15, which states:

"...Every domestic HMO shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions, and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of business transacted."

It is recommended that the Company comply with ALA. CODE § 27-7-30(e) (1975), which requires the following:

"Subject to the producer's contract rights, if any an insurer or authorized representative of the insurer may terminate a producer's appointment at any time. An insurer or authorized representative of the insurer that terminates the appointment, employment, or contract with a producer for any reason shall within 30 days following the effective date of the termination, using a format prescribed by the commissioner, give notice of the termination to the commissioner."

It is recommended that the Company acquire insurance coverage on e-business transactions to cover any liability claims. COMPANY OPERATIONS/MANAGEMENT Standard 2, of the NAIC's Market Conduct Examiners Handbook requires that the Company has appropriate controls, safeguards and procedures for protecting the integrity of computer information.

It is recommended that the Company acquire insurance coverage on e-business transactions to cover any liability claims. COMPANY OPERATIONS/MANAGEMENT Standard 2, of the NAIC's Market Conduct Examiners Handbook requires that the Company has appropriate controls, safeguards and procedures for protecting the integrity of computer information.

It is recommended that the Company implement disaster recovery plans that encompass the recovery of the Company's Wide Area Network (WAN). COMPANY OPERATIONS/MANAGEMENT Standard 2, of the NAIC's Market Conduct Examiners Handbook requires that the Company has appropriate controls, safeguards and procedures for protecting the integrity of computer information.

It is recommended that the Company test its business contingency plan to insure that all significant business activities, including financial functions, telecommunication services, and data processing and network services work properly.

It is again recommended that the Company maintain complete and accurate records in accordance with ALA. ADMIN. CODE 482-1-079-.15 (1987), which states:

> "Every domestic HMO shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions, and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of business transacted."

It is again recommended that the Company provide responses within ten working days for information requested by personnel representing the Alabama Department of Insurance in accordance with Section 6 of Alabama Department of Insurance Regulation No. 118, which states:

"The insurer shall provide, within ten (10) working days, any record or response requested in writing by any duly appointed deputy, assistant, employee or examiner of the commissioner."

It is recommended that the Company include all changes in premium deficiency reserves in the Increase in Reserves for Life and Accident and Health Contracts line in future financial filings in accordance with the NAIC Annual Statement Instructions.

Bonds – Page 37

It is recommended that the Company correctly report NAIC designations for its securities in accordance with the NAIC Purposes and Procedures Manual of the Securities Valuation Office.

It is again recommended that the Company maintain purchase and sales advices to support its investment transactions in accordance with ALA. ADMIN. CODE 482-1-079-.15 (1987), which states:

"Every domestic HMO shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions, and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds of business transacted."

Cash – Page 37

It is again recommended that the Company reconcile each bank account separately rather than having one reconciliation per bank. This was noted in the prior two examination reports.

It is recommended that the Company monitor the fair value of the underlying collateral of its repurchase account to ensure that this amount is at least equal to 102% of the purchase price of the security in accordance with SSAP No. 45, paragraph 8 (a).

It is recommended that the Company report its repurchase agreements on Schedule DA - Part 1 in future financial filings in accordance with the NAIC Annual Statement Instructions and the NAIC Accounting Practices and Procedures Manual- SSAP No. 45, paragraph 4.

Investment income due and accrued - **Page 38**

It is recommended that the Company only include due and accrued interest in the appropriate columns of Schedule D - Part 1, Schedule DA - Part 1, Schedule E - Part 1 and Schedule E - Part 2 in accordance with the NAIC Annual Statement Instructions. **It is recommended** that the sum of due and accrued interest from these schedules tie to the Investment income due and accrued line item on the balance sheet. **It is again recommended** that the Company report its investment income due and accrued in its future financial filings.

Uncollected premiums and agents' balances in the course of collection- **Page 38**

It is recommended that the Company maintain documentation for all components of its Uncollected premiums and agents' balances in the course of collection in accordance with ALA. ADMIN. CODE 482-1-079-.15, which states:

> "An Alabama domiciled (domestic) HMO shall keep all necessary records in an Alabama location required for the efficient examination of its financial condition and health care delivery system. ...Every domestic HMO shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions, and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of business transacted."

Net deferred tax asset - **Page 39**

It is recommended that the Company correctly reflect its deferred tax asset in future financial filings in accordance with the NAIC Annual Statement Instructions and the NAIC Accounting Practices and Procedures Manual.

Receivable from parent, subsidiaries and affiliates - **Page 39**

It is again recommended that the Company comply with ALA. Code § 27-41-36(a) (1975), which states:

> "...an insurer shall not invest in nor lend its funds upon the security of any note or other evidence of indebtedness of any director, officer or controlling stockholder of the insurer..."

Healthcare and other amounts receivable - **Page 39**

It is recommended that the Company calculate its guaranteed pharmacy rebates in accordance with the contract.

Claims unpaid - **Page 40**

It is again recommended that procedures be established to insure that, for the purposes of reporting claims by incurral month for developing lag factors, reinsurance recoveries should be allocated to the appropriate month of incurral.

It is recommended that the Company report and remit unclaimed property to the State Treasurer under guidelines found in ALA. CODE §35-12-76 (2004).

It is recommended that the Company maintain documentation for all capitation settlement transactions in accordance with ALA. ADMIN. CODE 482-1-079. -015, which states:

> "An Alabama domiciled (domestic) MHO shall keep all necessary records in an Alabama location for the efficient examination of its financial condition health care delivery system. ...Every domestic HMO shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions, and affairs in accordance with such methods and system as are customary or suitable as to the kind, or kinds, of business transacted."

Accrued medical incentive pool and bonus amounts – **Page 41**

It is recommended that the Company maintain complete records of its assets, transactions and affairs, so as to be able to determine the correct amount of the accrued medical incentive pool from year to year in accordance with ALA. ADMIN. CODE 482-1-079-.15 (1987), which states:

> "Every domestic HMO shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions, and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of business transacted."

Aggregate health policy reserves - **Page 41**

It is recommended that the Company establish premium deficiency reserves in accordance with SSAP No. 54, paragraph 18 and the Health Reserves Guidance Manual.

General expenses due or accrued - **Page 42**

It is recommended that the Company evaluate its premium taxes and establish appropriate premium tax accruals in future financial statements.

Amounts withheld or retained for the account of others - **Page 42**

It is again recommended that the Company file its unclaimed reports by the first of November in accordance with ALA. CODE §35-12-76 (c) (2004), which states:

"The report shall be filed before November 1 of each year and cover the 12 months next preceding July of that year."

It is again also recommended that the Company report all unclaimed property over three years old in accordance with ALA. CODE §35-12-72 (2004), which states:

"(a) Property is presumed abandoned if it is unclaimed by the apparent owner during the time set forth below for the particular property:...(18) All other property, three years after the owner's right to demand the property or after the obligation to pay or distribute the property arises, whichever first occurs."

Gross paid in and contributed surplus - **Page 43**

It is recommended that the Company maintain all supporting documentation of its gross paid in and contributed capital transactions in accordance with ALA ADMIN. CODE 482-1-079-.15, which states:

"An Alabama domiciled (domestic) HMO shall keep all necessary records in an Alabama location for the examination of its financial condition health care delivery system. ...Every domestic HMO shall have, and maintain, its place of business and home office in this state and shall keep therein complete records of its assets, transaction, and affairs in accordance with such methods and system as are customary or suitable as to the kind, or kinds of business transacted."

CONCLUSION

The customary examination procedures, as recommended by the National Association of Insurance Commissioners for health maintenance organizations, have been followed in connection with the verification and valuation of assets and the determination of liabilities set forth in this report.

In addition to the undersigned, the following persons represented the Alabama Department of Insurance as participants in this examination: Tisha Freeman, examiner, Theo Goodin, examiner, Charles Turner, examiner, Lori Wright, examiner and Harland A. Dyer, ASA, MAAA, FCA, actuarial examiner.

Respectfully submitted,

Rhonda B Ball

Rhonda B. Ball
Examiner-in-Charge
Alabama Department of Insurance